Cypress CAPITAL

Market Outlook

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The Cost of Peak Inflation

Market Risk Index shot higher to 71% as the Psychology composite moved above the 50th percentile. Psychology has been shifting rapidly after bottoming out a little less than a month ago with readings below 15%, firmly in fear territory.

The stock market reacted dramatically to a peak in CPI inflation on Thursday, the kind of outsized price increase that tends to only occur in bear market rallies. The Inflation category of our Monetary composite shifted positive (bullish) on September 26th, indicating that an inflation peak was forthcoming, but it did so within weeks of our Interest Rate Spreads category going negative due to the yield curve inversion. The Monetary composite message is clear. The cost of beating inflation into submission is an economic recession. Based upon this, we objectively ruled out the “pivot with a soft-landing” narrative – ours is an objective, data-driven decision.

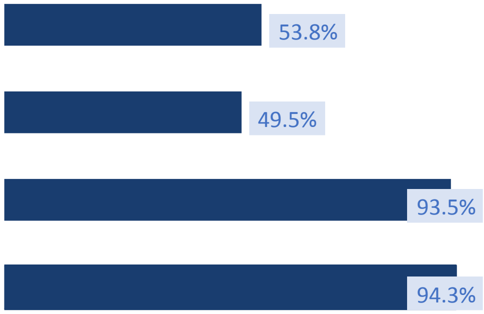
There are historical precedents for inflation peaks leading to solid market rallies, and even new bull markets, so this bear market rally with a favorable post-midterm seasonal backdrop could continue to press on for several weeks. Growing confidence in a Fed pivot or any other temporary good news could easily lull investors into believing the bear market is in the rear-view mirror (absent some Fed jawboning). However, as 2023 begins and inflation fears continue to recede, recession fears will build, likely leading to another leg down in the bear market.

Market Risk Index

Rec Allocation 25% Underweight

71.0%

Category Percentiles



Largest Psychology Influences

Surveys	Positive
Option Activity	Positive
Leveraged Investments	Negative
Fund Flows	Negative

Largest Monetary Influences

Interest Rates	Negative
Exchange Rates	Positive
Interest Rate Spreads (Yield Curve)	Negative

Valuation

7-10 Year Equity Return Forecast	2.5%
10Yr US Treasury Yield	3.8%

Market Trends

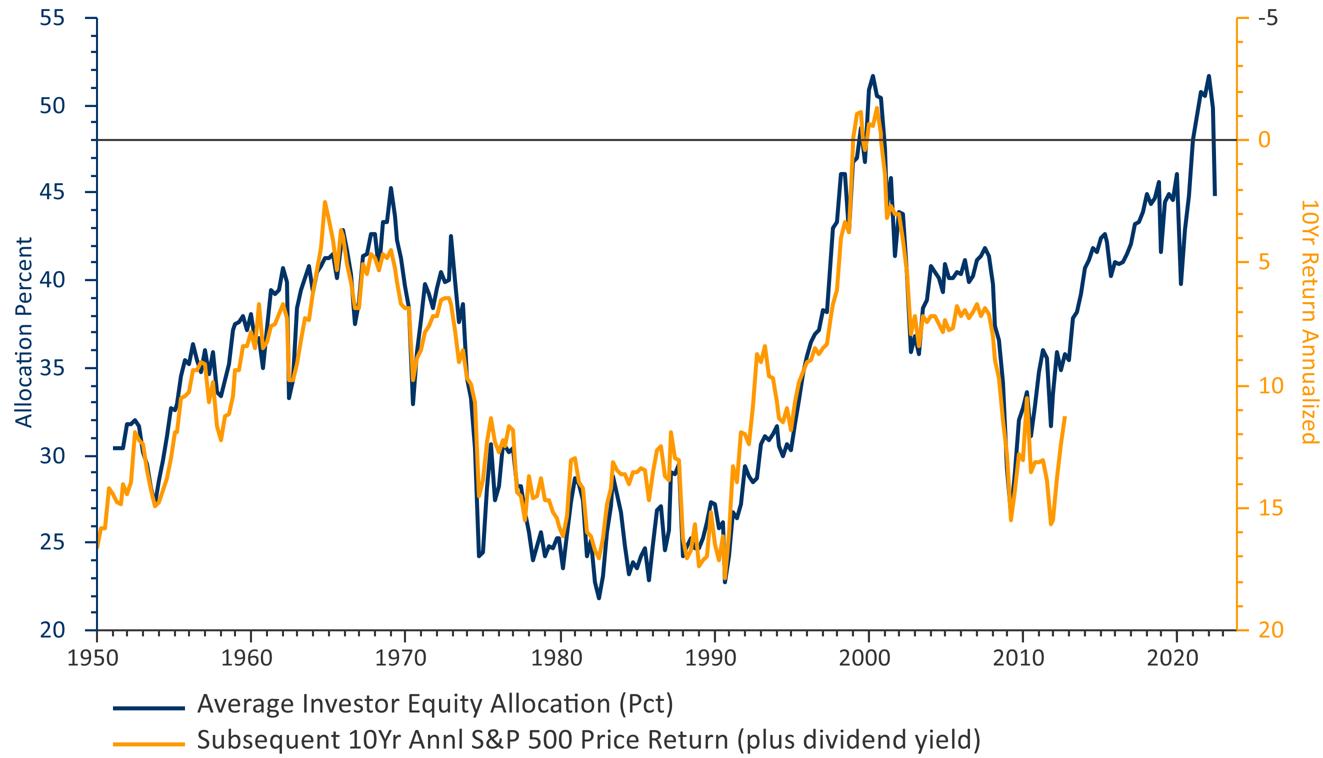
US Equities	Bearish Trade
Intl Equities	Bearish Trade
REITs	Bearish Trade
Broad Commodities	Bullish Investment

Market Risk Index scales from 0 to 100%. Higher readings correspond with higher risk markets. Scores below 25% are bullish. Scores between 25-75% are neutral, and scores above 75% are markets vulnerable to major drawdowns.

Charts of the Week

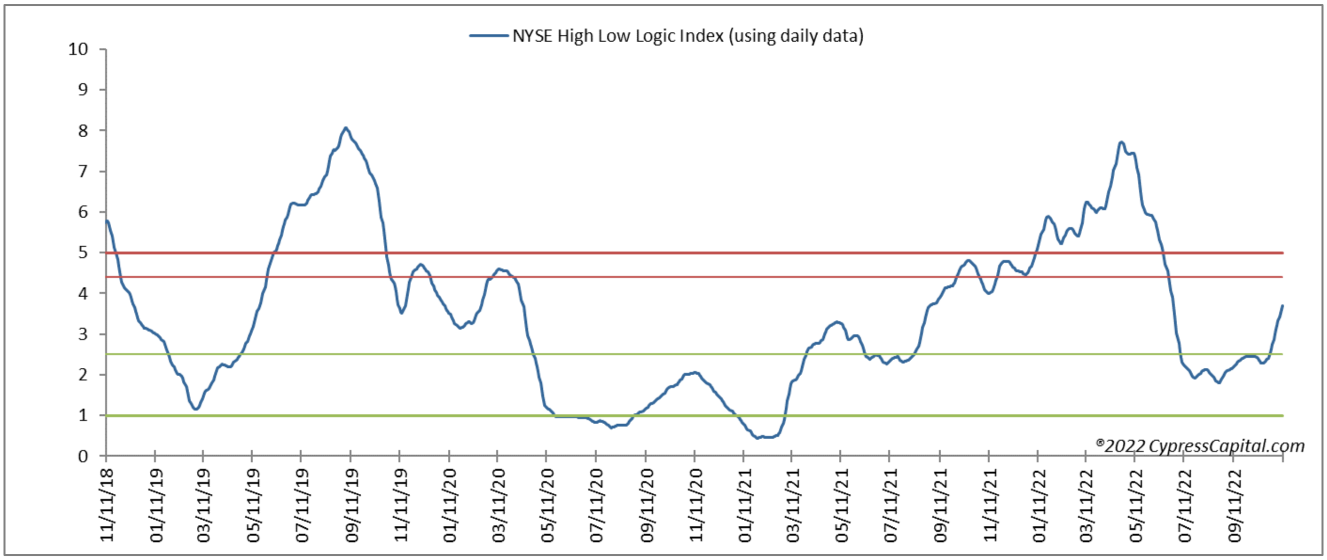
Average Investor Equity Allocations

Despite a bear market in stocks, the bear market in bonds has left investors with above-average equity allocations. Investor equity allocations have a whopping 93% correlation with stock returns over the ensuing ten years. Current equity positioning implies returns of roughly 2% for stocks, half of what one could earn from buying a US Treasury bond. No bear market has bottomed with such heavy equity exposure.

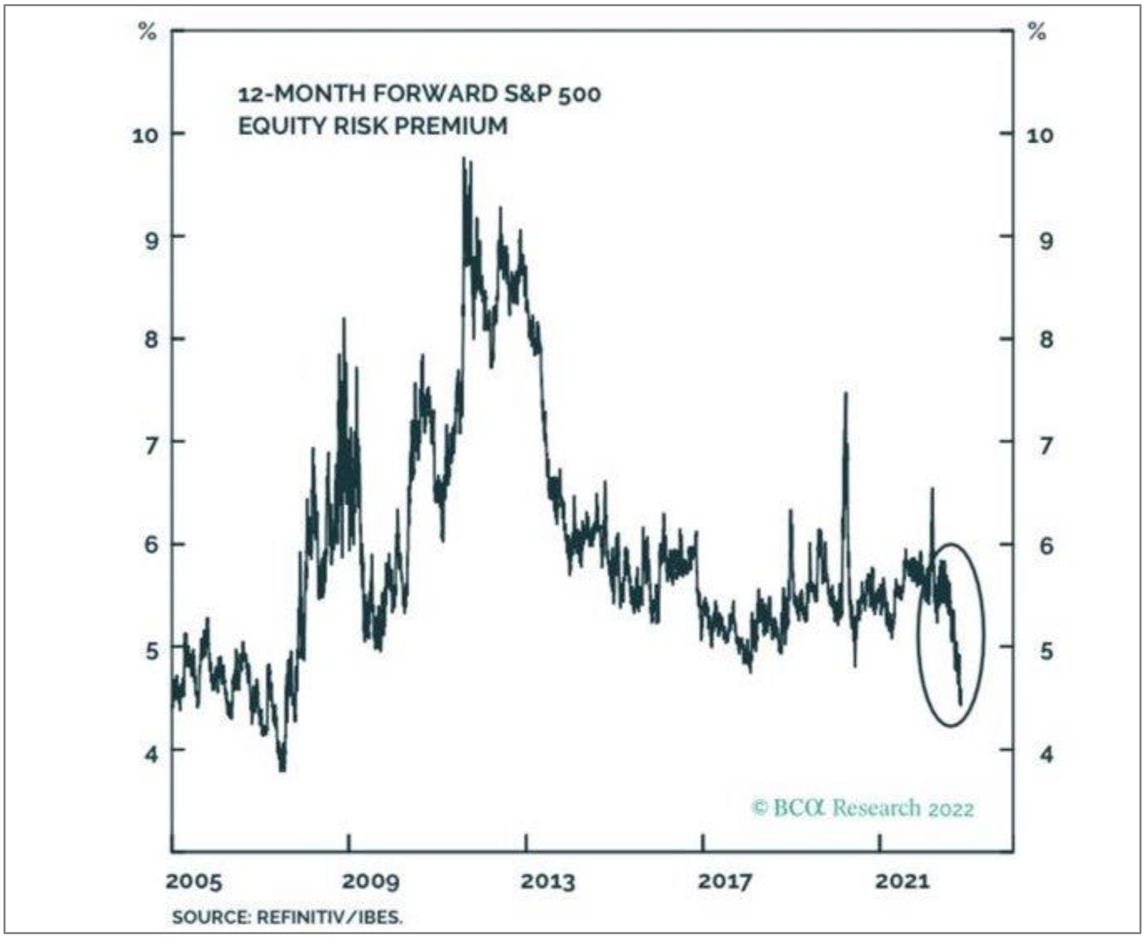


Source: Refinitiv Datastream, Federal Reserve, Cypress Capital

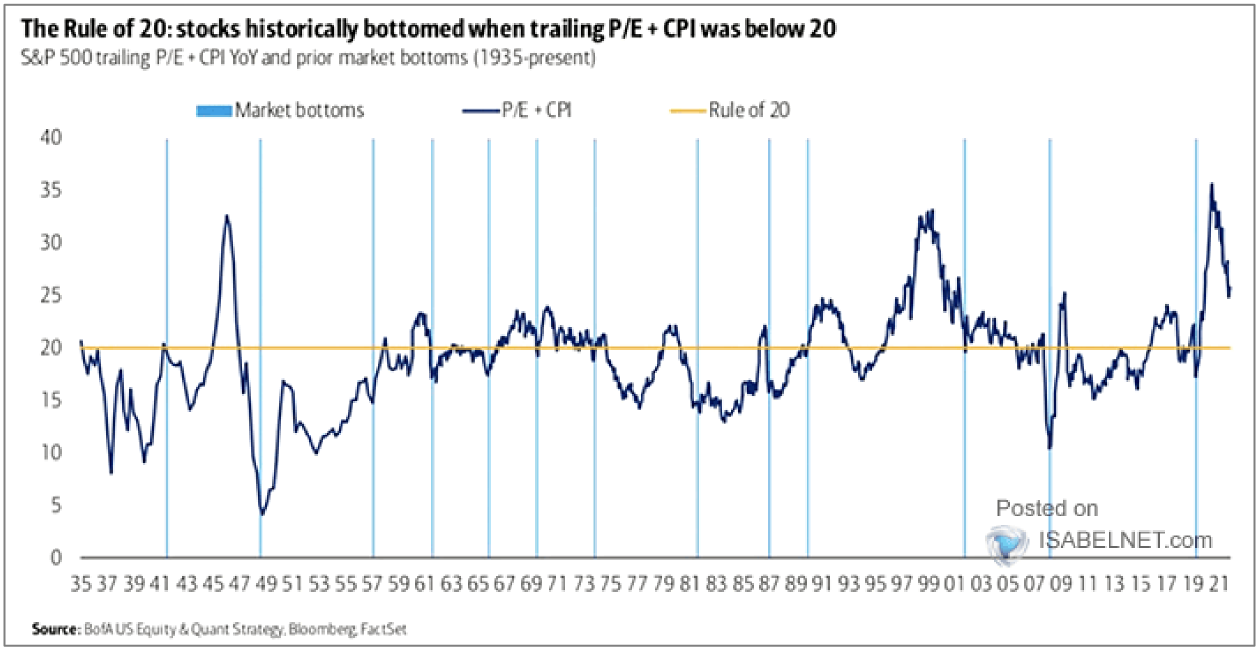
NYSE High Low Logic Index
Recent market behavior (outside of Thursday's response to CPI) has started to drive our High Low Logic Indicator higher, indicating that current market strength has been less than uniform. Any new signals of a split market (hitting one of the red lines) would lead us to reduce equity exposure. This indicator has a history of triggering sell signals toward the end of more robust bear market rallies.



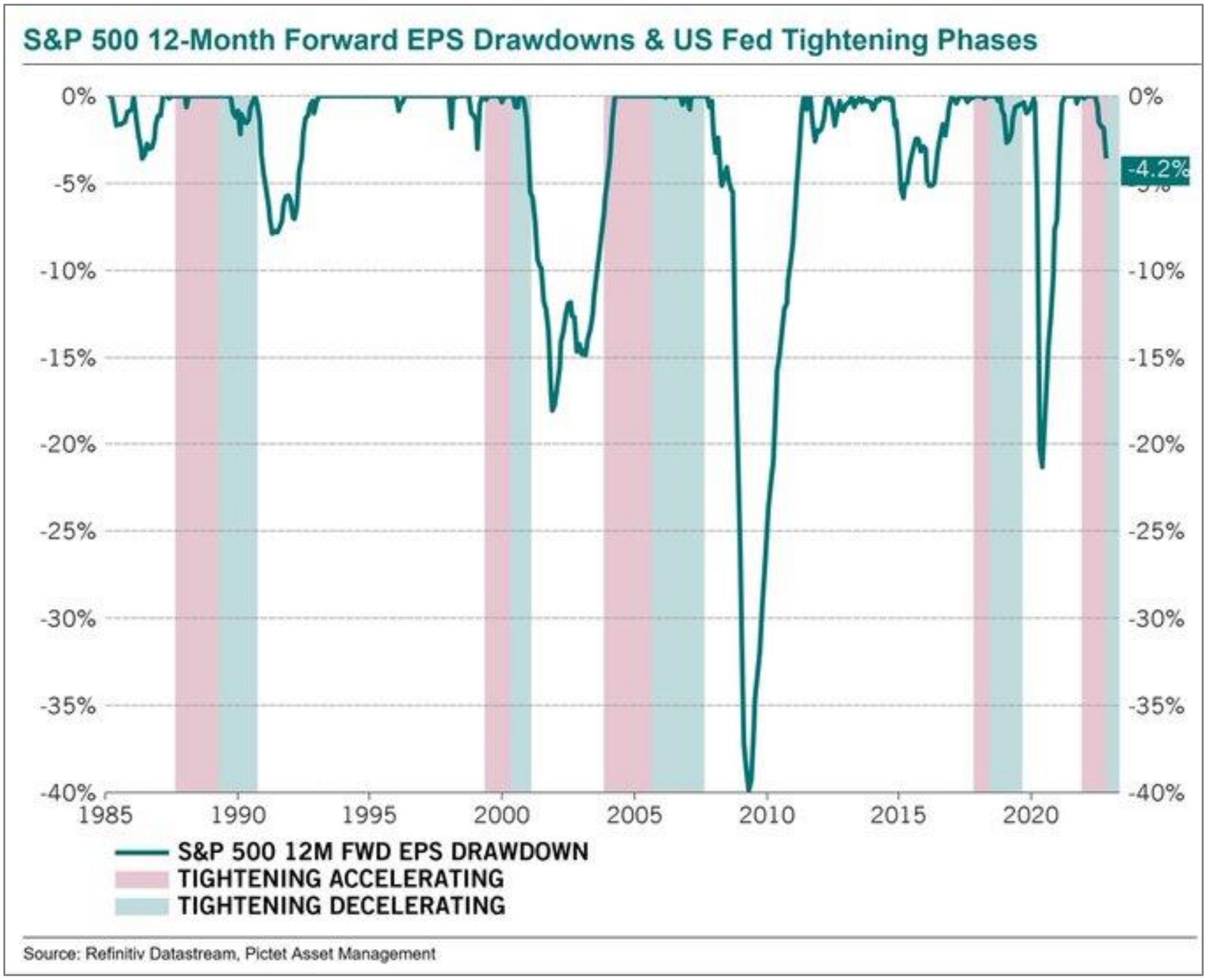
The bond bear market has caused the Equity Risk Premium to fall inside an equity bear market.



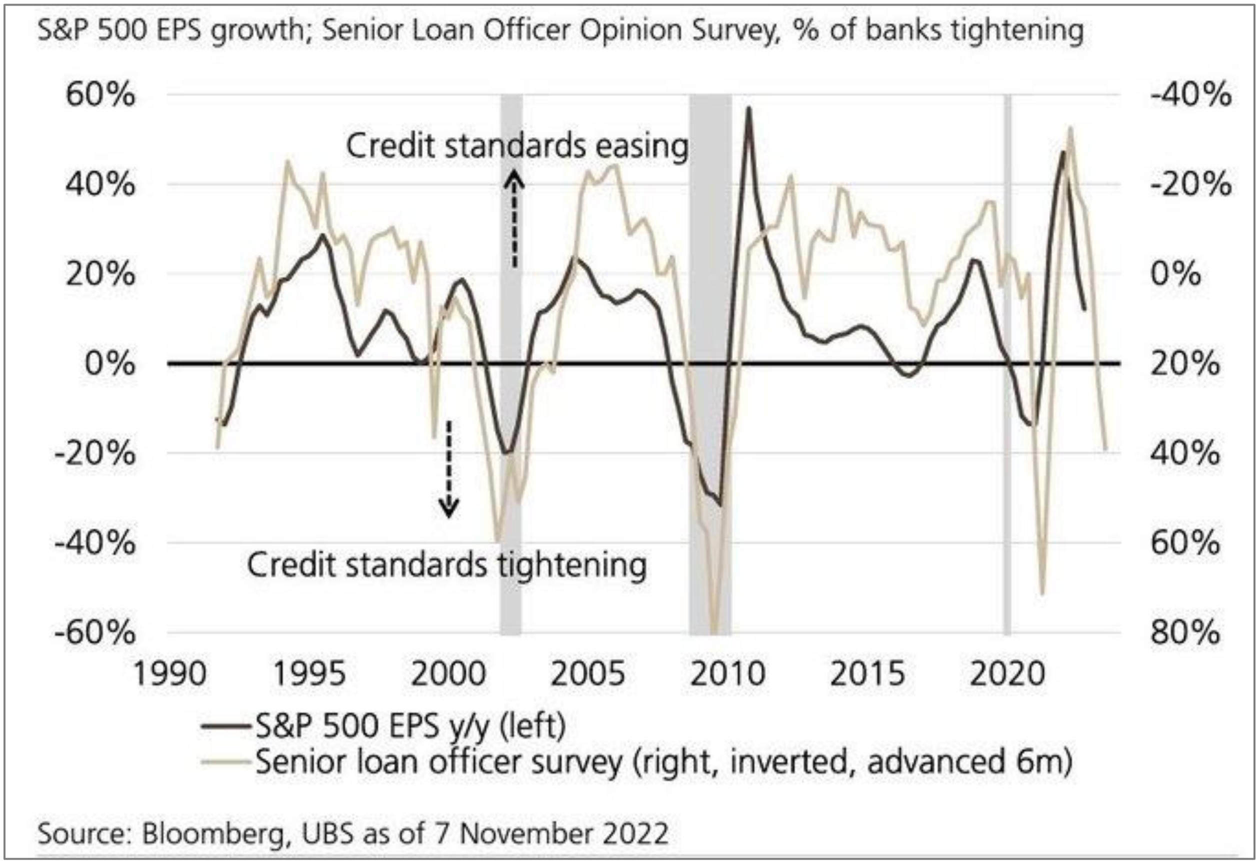
Stocks are overvalued based upon the Rule of 20 using CPI.



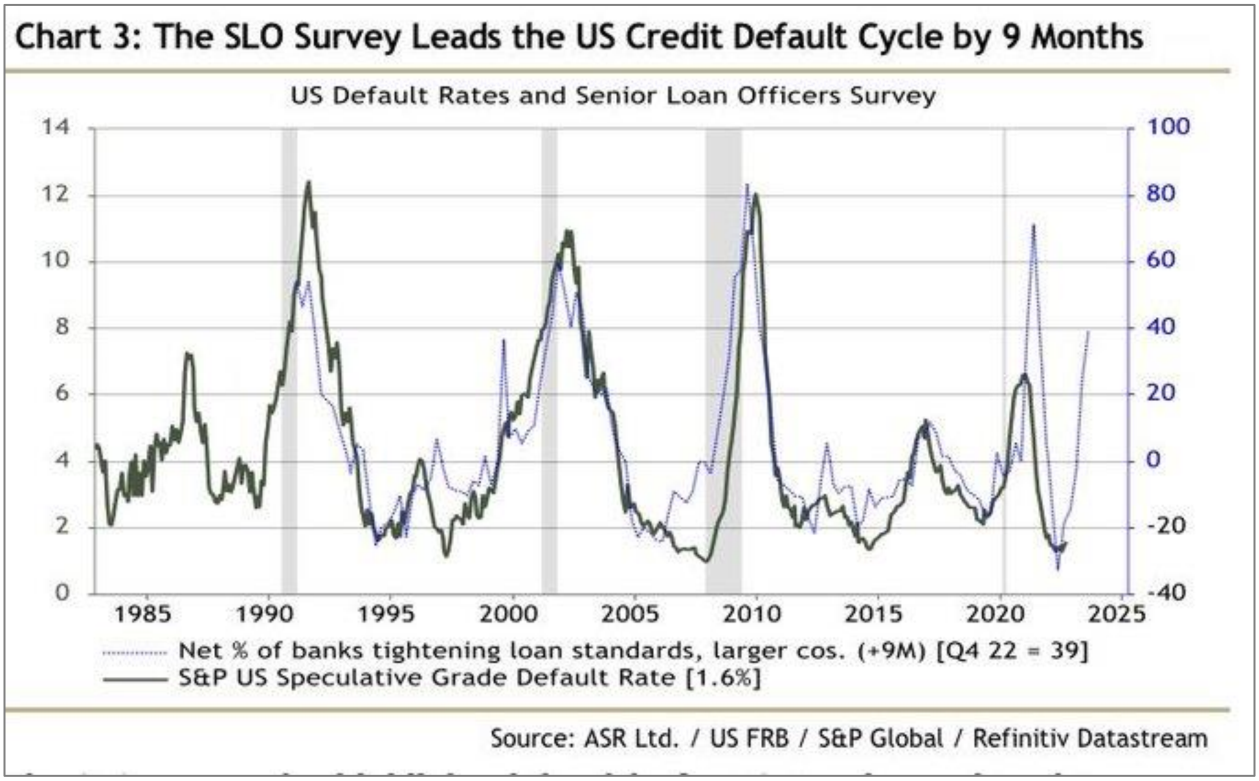
Earnings recessions begin after Fed pivots.



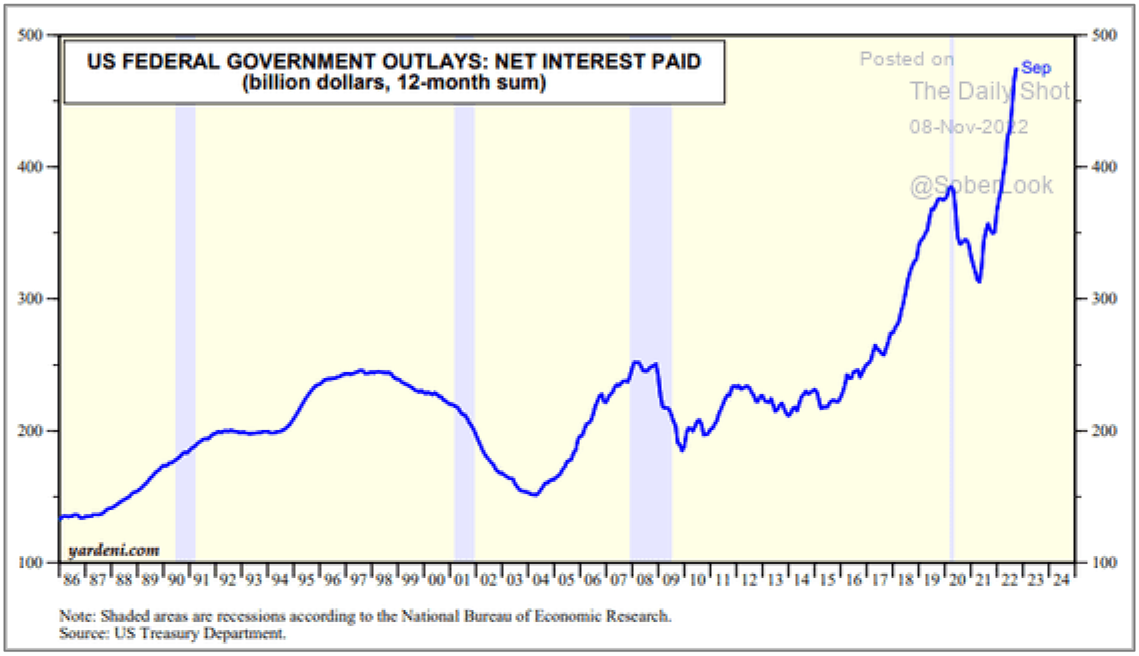
Earnings recessions also come after Banks have tightened Lending standards.



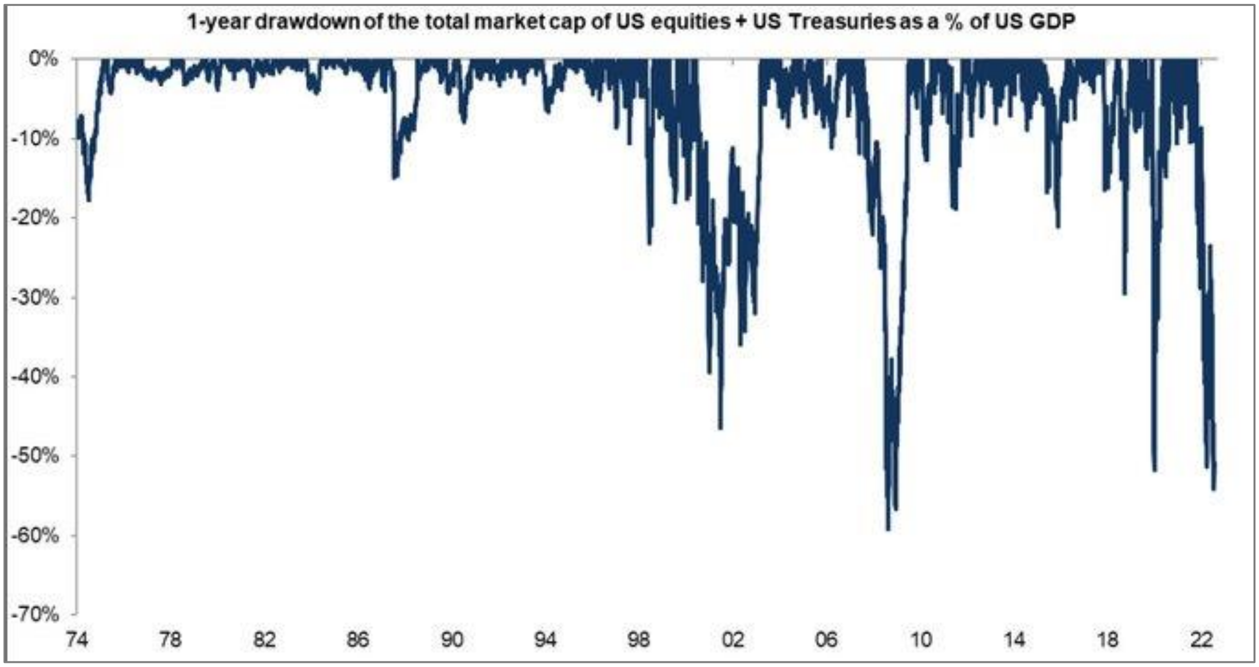
Credit Defaults also rise after banks tighten Lending standards.



Uncle Sam is feeling the sting of higher interest rates.

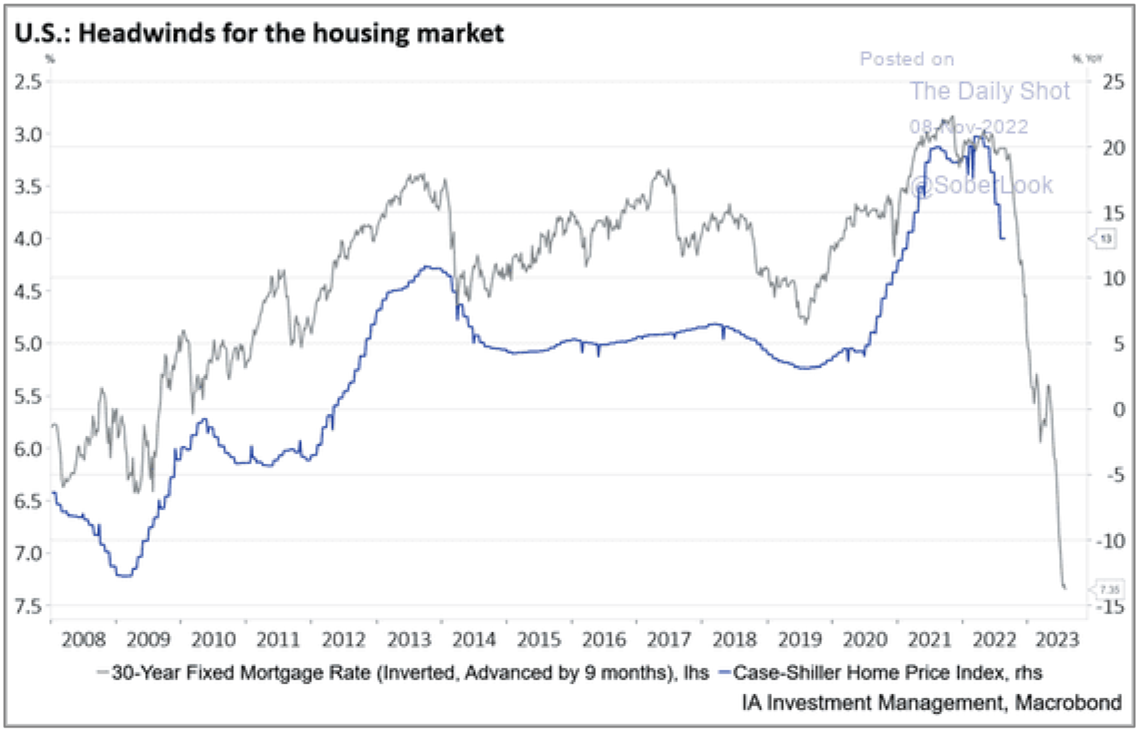


Substantial hit to wealth in 2022 when you look at the damage done to both stocks and bonds.



Source: @PhilipJagd

Mortgage rates indicate a challenging environment for home prices through the first half of 2023.



Commercial Bank deposits are declining for the first time since 1995.

Asset Management – Portfolio Lineup

The essence of investment management is the management of risks, not the management of returns.
– Benjamin Graham

Select Dividend – Bottom-up risk-managed dividend portfolio of up to 40 stocks that can hold cash and fixed income when markets aren't presenting attractive individual equity opportunities. A portfolio built upon Cypress Capital's metrics that measure dividend quality and safety. The portfolio is divided 75/25 into payers and growers. Payers are stocks having above-average yields with a long-term history of paying dividends, where the dividend is perceived to be safe. Growers are companies with high total shareholder yields and perceived to be high-quality, franchise companies. The portfolio is generally made up of familiar, household names.

Global Allocation – Multi-asset class portfolio that invests in low-cost exchange-traded funds across eight asset classes based upon the margin of safety offered by each asset class to avoid significant drawdowns.

Strategic Income – Disciplined, value-biased income portfolio that practices patience in awaiting excellent risk-reward opportunities in fixed income. Disciplined in its refusal to reach for yield and put capital at risk of permanent impairment.

Asset Neutral – Absolute return-focused multi-asset class portfolio that allocates assets based upon the margin of safety offered in each asset class. The portfolio can go defensive and hold up to 100% cash in some environments.

US Opportunity – Concentrated value portfolio of up to 50 stocks that increases allocations to cash and fixed income when the margin of safety offered by equities is too narrow. Portfolio quantitatively buys the cheapest, highest quality stocks that it can find. Quantitative sell discipline sells individual holdings based on value and momentum factors.

Contact us for more information.